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Lecture

SINGAPORE ACADEMY OF LAW DISTINGUISHED SPEAKER LECTURE 2017 – "THE DOCTRINE OF PENALTIES IN MODERN CONTRACT LAW"*

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I. Introduction

1 In 1986, Mason and Wilson JJ of the High Court of Australia noted in the decision of *AMEV-UDC Finance Ltd v Austin*[1] that "[t]he doctrine of penalties has pursued such a tortuous path in the course of its long development that it is a risky enterprise to construct an argument on the basis of the old decisions".[2] Almost 30 years later, Lord Neuberger and Lord Sumption of the UK Supreme Court began their reasons in the conjoined appeals of *Cavendish Square Holding BV v Makdessi* and *ParkingEye Ltd v Beavis*[3] with similar sentiment, noting that the penalty rule is an "ancient, haphazardly constructed edifice which has not weathered well".[4] As anyone with an interest in history will be familiar, there is often more than one truth in describing how something emerges from the past, and so it is the case with the doctrine of penalties. Two versions of history have led to different choices as to legal doctrine. What remains to be done, however, is to fully fashion a modern doctrine with contemporary social and commercial relevance and utility. But the cases to which I will refer hopefully have begun that task.

2 The final appellate courts in Australia and the UK have recently revisited the law on penalties. In 2012, in *Andrews*,[5] and in subsequent litigation of the matter in 2016 in *Paciocco*,[6] the Australian High Court

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1 *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170; HCA 63.

2 *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170 at 186, *per* Mason and Wilson JJ.

3 *Cavendish Square Holding BV v Makdessi; ParkingEye Ltd v Beavis* [2016] AC 1172; [2015] UKSC 67.

4 *Cavendish Square Holding BV v Makdessi; ParkingEye Ltd v Beavis* [2016] AC 1172 at 1192; [2015] UKSC 67 at [3], *per* Lord Neuberger and Lord Sumption.

5 *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205; HCA 30.

6 *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 258 CLR 525; HCA 28.

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considered whether certain banking fees charged to customers of ANZ bank were penalties. In 2015, the Supreme Court of the UK heard two distinctly different cases in dealing with the doctrine. *Cavendish* concerned the enforceability of certain non-competition provisions in a substantial commercial sale and purchase agreement that delivered to Cavendish the controlling interest in a business founded by Mr Makdessi and described in the reasons as the "largest advertising and marketing communications group in the Middle East".[7] The provisions under scrutiny were provisions that, upon the occasion of their breach, would prevent Mr Makdessi and his business partner as defaulting shareholders from being paid the remainder of the purchase price and require them to sell Cavendish their remaining shares in the business based on a formula that excluded a substantial value for goodwill.[8] *ParkingEye* concerned a parking fee charged to Mr Beavis of £85 for overstaying (by nearly one hour) the permitted (and free) parking time (two hours) in a retail carpark run by ParkingEye. Neither was held to be a penalty – an indication of the movement of the modern law to accommodate freedom of contract.

3 The differences between the two courts included the identification of the modern origins of the doctrine – in equity or at common law; and whether the doctrine's application is conditioned on a breach of contract or whether it has a broader application in circumstances where a collateral stipulation provides for a benefit to a party upon the failure of a primary stipulation in favour of that party by way of security for and *in terrorem* of the satisfaction of the primary stipulation.[9]

4 I do not propose to engage in debate about the correctness of the reasoning of either court. I leave that to senior academics to fulfil their function in legal discourse in that regard. I would only note that the decision in *Andrews* was the subject of strong criticism in an article, unusually, co-authored by five very senior contract law academics.[10] *Paciocco*, *Cavendish* and *ParkingEye* have fared little better.[11] Whilst I have some sympathy for some of the criticism, the nature of the

7 *Cavendish Square Holding BV v Makdessi; ParkingEye Ltd v Beavis* [2016] AC 1172 at 1210; [2015] UKSC 67 at [44], *per* Lord Neuberger and Lord Sumption.
8 *Cavendish Square Holding BV v Makdessi; ParkingEye Ltd v Beavis* [2016] AC 1172 at 1212; [2015] UKSC 67 at [55], *per* Lord Neuberger and Lord Sumption.
9 *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 216–217; HCA 30 at [10].
10 J W Carter *et al*, "Contractual Penalties: Resurrecting the Equitable Jurisdiction" (2013) 30 *Journal of Contract Law* 99.
11 See J W Carter, Wayne Courtney & G J Tolhurst, "Assessment of Contractual Penalties: *Dunlop* Deflated" (2017) 34 *Journal of Contract Law* 4 and Professor Sarah Worthington QC, "The Death of Penalties in Two Legal Cultures?" (2016) 7 *The UK Supreme Court Yearbook* 129.

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criticism and the approaches of the two courts reveal two important aspects of doctrinal development and legal thinking that are worthy of comment: the futile struggle to define the indefinable; and the extent of the legitimacy and utility in resurrecting from the mists of centuries past doctrine to displace stable (if less than satisfactory) approaches that have sufficed for generations, in preference to reformation of doctrine by reference to contemporary expression of informing concepts.

5 Nor do I propose to take you through all the detail of the various judgments in the Supreme Court and High Court to piece together the precise precedential position. Rather, I wish to examine the position taken by the two courts, the changes they have made, and where we might go from here.

II. Historical approaches to the equitable origins of the penalties' doctrine

6 The historical arguments adopted by the two courts reveal differences in perspective on the way in which the penalty rule evolved from the equitable jurisdiction for relief from conditional defeasible penal bonds.[12] The debate is whether the rule can be said to have cast off its equitable origins to such a degree that it can properly be held to be a rule of, and only of, the common law. Central to this question is a difference of view about the legal effect of the Judicature Acts of the 1870s.

7 The English approach which reflects the broadly accepted position in Australia before *Andrews* is to apply the doctrine in the common law of contract in the remedy for breach of contract. The Australian approach extends to reforming the contract in its operation, by flexible equitable relief, absent breach, although the availability of compensation is the source of the equity. Both approaches, however, are constructed around the necessary presence of related contractual provisions: primary, and secondary or accessorial or collateral provisions.

8 The differences also perhaps reveal a greater role for equitable modes of thought in legal doctrine in Australia, and an unwillingness to shorten the historical roots of modern law to the positivist 19th century, where a greater emphasis on rule-based structure may be perceived in comparison to the earlier centuries. The echo of this can perhaps be

12 On this topic, see in particular the following essay: A W B Simpson, "The Penal Bond with Conditional Defeasance" (1966) 82 *Law Quarterly Review* 392.

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seen in the different approaches to the law of unjust enrichment and restitution in England and Australia.[13]

9 Some historical reflection on the doctrine of penalties is also important in order to understand the unsatisfactory attempts by the courts at certain times to define into certainty the heart of the doctrine, a heart which does not admit of definition. This indefinability comes from the value-based composition of that heart – a refusal of the courts to countenance oppression, private punishment, or unconscientious arrangements as a matter of legal policy. To put the matter thus is not to state a general rule about intervention in the bargains of parties; but rather, it is to express an informing norm or conception by reference to which rules are formed. Once this heart of the doctrine is appreciated, it becomes easier to understand that whilst rules can give form and structure, and thus some certainty, to the doctrine, they can never suffice as an exhaustive expression or definition of it. Just as one cannot define beauty or style, one cannot define unfairness, abuse of power or unconscionability.

10 As we shall see, both courts have moved away from a long-accepted structure based on the dichotomy of genuine pre-estimate of damages and penalty and the structure of Lord Dunedin's tests in *Dunlop*[14] to a more evaluative approach involving the assessment of the legitimacy of the parties' commercial and other interests inspired by Lord Atkinson in *Dunlop*[15] and the Earl of Halsbury LC in *Clydebank*.[16]

11 Normative values lie at the heart of the doctrine because (as with many legal principles) the doctrine is seeking to vindicate the human and experiential in the law – the law's humanity. This sometimes is lost sight of in the grasping for certainty by use of abstracted or theoretical rules in taxonomical structures in order to define doctrine in concrete form. These almost dialectical relationships: between the experientially human, and the abstracted; between the evaluation of circumstance and context, and the application of the abstracted de-contextualised rule to the particular; and between value-based

13 See James Allsop, "Rules and Values in Law: Greek Philosophy; the Limits of Text; Restitution; and Neuroscience – Anything in Common?", speech delivered at a seminar of the Hellenic Australian Lawyers Association – Queensland Chapter (29 March 2017).

14 *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 at 86–88, *per* Lord Dunedin.

15 See especially *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 at 92–93, *per* Lord Atkinson.

16 *Clydebank Engineering and Shipbuilding Co Ltd v Yzquierdo y Castaneda* [1905] AC 6.

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principle, and defined rule, underlie all law and provide for its organic growth, tolerable stability, and capacity to adapt to social change.[17]

A. A short introduction to the history of the penal bond with conditional defeasance

12 The absence until recent centuries of a mutual promise-based contract law of modern recognition did not reflect a lack of importance of the promise and the bargain in human exchange in medieval times. The promise and the bargain were vindicated in different ways. Commerce has always been sophisticated. The commercial engagement, the experiential, gave rise to the need for rules reflecting decent human behaviour.

13 The penal bond was employed as a means of regulating interlocking promises in commerce.[18] Delivered as a deed, the obligor confessed himself to be obliged to the obligee. The bond could be sued on in debt. The bond (the instrument) created the debt, not the underlying promise. The bond could be simple and absolute, or it could be conditional. The latter could be used to regulate or enforce unilateral or bilateral undertakings or promises. The obligor was obliged to pay £x on y date, but if the undertakings or stipulations or promises were performed, the bond would be void. If there were any complexity in the mutual engagement, an indenture under seal would be entered into setting out the terms of the agreement. Each party would execute a penal bond of even date in the event of non-performance of their obligations in the indenture, or of any relevant stipulation within his ken.[19]

14 One can see the framework for simple or sophisticated commercial transactions based on promise, stipulation and performance. One can see certainty and due enforcement by the

17 See James Allsop, "Values in Law: How they Influence and Shape Rules and the Application of Law", paper delivered at the Centre for Comparative and Public Law, Faculty of Law, University of Hong Kong Hochelaga Lecture Series (20 October 2016).

18 Christopher John Rossiter, *Penalties and Forfeiture: Judicial Review of Contractual Penalties and Relief against Forfeiture of Proprietary Interests* (The Law Book Company Limited, 1992) at pp 2–3; see also A W B Simpson, "The Penal Bond with Conditional Defeasance" (1966) 82 *Law Quarterly Review* 392.

19 This description of the penal bond is drawn from Christopher John Rossiter, *Penalties and Forfeiture: Judicial Review of Contractual Penalties and Relief against Forfeiture of Proprietary Interests* (The Law Book Company Limited, 1992) at pp 1-3.

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unequivocal nature of the penal sum, and the requirement for strict performance.[20]

15 The vindication of values of fairness and control of oppression grew in the development of the jurisdiction in Chancery to relieve against penal bonds in certain respects. By Tudor times, medieval mechanisms such as the defeasible bond were adapted to complex transactions.[21] Lord Neuberger and Lord Sumption suggest that by the early 16th century, the defeasible bond was seen as a way to "secure the performance obligations sounding in damages".[22] Such defeasible bonds were popular, particularly given the "unequivocal imposition of the obligation", coupled with the fact that there existed few defences at law to proof of debt.[23]

16 The common law courts readily upheld such defeasible bonds, recognising that they were a useful means of avoiding the canonical usury laws, and that they were a means of pricing risk and credit; but from the 16th century, the Court of Chancery intervened against the often harsh outcome for the obligor, in particular in the circumstances of the payment of a sum of money in default of payment of a smaller sum of money.[24] In equity's eyes, the rationale of the penal bond was as a security for performance – for the actual loss sustained by the innocent party – and should be treated as such.[25] One can see the echo not only of relief against forfeiture here, but also the development of the protection of the equity of redemption – once a mortgage, always a mortgage. As Lord Macclesfield LC put it in *Peachy v Duke of Somerset*, equitable relief stemmed from "the original intent of the case, where the penalty is designed only to secure money, and the court gives him all that he

20 See Christopher John Rossiter, *Penalties and Forfeiture: Judicial Review of Contractual Penalties and Relief against Forfeiture of Proprietary Interests* (The Law Book Company Limited, 1992) at pp 1–3.

21 Samuel E Thorne, "Tudor Social Transformation and Legal Change" (1951) 26 NYU L Rev 10 at 21.

22 *Cavendish Square Holding BV v Makdessi; ParkingEye Ltd v Beavis* [2016] AC 1172 at 1192; [2015] UKSC 67 at [4], *per* Lord Neuberger and Lord Sumption.

23 See Christopher John Rossiter, *Penalties and Forfeiture: Judicial Review of Contractual Penalties and Relief against Forfeiture of Proprietary Interests* (The Law Book Company Limited, 1992) at p 3.

24 Christopher John Rossiter, *Penalties and Forfeiture: Judicial Review of Contractual Penalties and Relief against Forfeiture of Proprietary Interests* (The Law Book Company Limited, 1992) at pp 3–4; see also Anthony Gray, "Contractual Penalties in Australian Law after *Andrews*: An Opportunity Missed" (2013) 18 *Deakin Law Review* 1 at 3.

25 *Cavendish Square Holding BV v Makdessi; ParkingEye Ltd v Beavis* [2016] AC 1172 at 1192; [2015] UKSC 67 at [4], *per* Lord Neuberger and Lord Sumption.

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expected or desired".[26] Petitions to Chancery thus allowed the obligor to sidestep the harsh consequences of penalty provisions provided that he or she paid to the obligee the amount of ascertained actual damage, including interest.[27] Williston noted that circumstances when the courts of equity would step in were when "literal enforcement of the obligation [was regarded] as unconscientious".[28]

17 The practice of Chancery to restrain enforcement of the bond was commonplace from around 1630.[29] Lord Neuberger and Lord Sumption in *Cavendish* described the way that in response to Chancery's practice, the equitable rule was soon "adopted" by the common law, writing:[30]

> Towards the end of the 17th century, the courts of common law tentatively began to stay proceedings on a penal bond to secure a debt,

26 *Peachy v Duke of Somerset* (1720) 1 Strange 447 at 453, as quoted in *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1193; [2015] UKSC 67 at [5], *per* Lord Neuberger and Lord Sumption.

27 *Austin v United Dominions Corp Ltd* [1984] 2 NSWLR 612 at 625, *per* Priestley JA.

28 Samuel Williston, *A Treatise on the Law of Contracts* vol 14 (Thomson Reuters, 4th Ed, 2000) at § 42:15, as quoted in *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 226; HCA 30 at [41].

29 R W Turner, *The Equity of Redemption* (Cambridge University Press, 1931) at pp 31–33, as quoted in *Austin v United Dominions Corp Ltd* [1984] 2 NSWLR 612 at 625, *per* Priestley JA; see also *Lord Nottingham's "Manual of Chancery Practice" and "Prolegomena of Chancery and Equity"* (Cambridge University Press, 1965), a collection of the Lord Chancellor's personal observation on the equitable jurisdiction of his day, in which he noted:

> [I]t is plain the Chancery doth daily relieve in all cases of condition broken, with this difference; where the breach of it is of such a nature that the breach of it may be recompensed in equity, there the breach shall be relieved; but where no satisfaction can be made for the breach, there no relief shall be against it in equity …

as quoted at 625, *per* Priestley JA.

30 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1193; [2015] UKSC 67 at [6], *per* Lord Neuberger and Lord Sumption; see also *Lord Nottingham's "Manual of Chancery Practice" and "Prolegomena of Chancery and Equity"* (Cambridge University Press, 1965), quoted in *Austin v United Dominions Corp Ltd* [1984] 2 NSWLR 612 at 625–626, *per* Priestley JA, where it was noted in relation to actions by now pleaded in assumpsit that:

> 10. In the midst of those cases which refer to this head, it may be worth the while a little to invert the rule, and to consider how far *lex sequitur equitatem*, that is, to observe how courts of law have changed their rules and, when they saw that equity would relieve, have chosen rather to relieve the parties themselves than send them hither.
>
> 11. Thus in all suits on bonds it's now become the course of the Court, that, if the defendant will pay the principal and interest and charges, the plaintiff shall be obliged to accept it till plea pleaded, else the defendant shall have a perpetual imparlance, and all this to prevent a suit in Chancery, which otherwise would give the same relief.

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> unless the plaintiff was willing to accept a tender of the money, together with interest and costs …

This approach was cemented through the enactment of the Statutes of William (1696–[16]97) and Anne (1705).[31]

18 As noted by Lord Neuberger and Lord Sumption "by the end of the 18th century the common law courts had begun to treat the statutory procedures as mandatory, requiring damages to be pleaded and proved and staying all further proceedings on the bond".[32]

B. The UK approach to the history of the penalties' doctrine

19 Importantly, Lord Neuberger and Lord Sumption saw the equitable jurisdiction to relieve against penalties to have arisen "wholly in the context of bonds defeasible in the event of the performance of a contractual obligation".[33] For the penalties' jurisdiction to be engaged, therefore, there has to have been some breach of that primary contractual obligation.[34] This is an important historical difference from the analysis of the High Court of Australia, which saw the operation of the doctrine not so limited.

20 Secondly, Lord Neuberger and Lord Sumption in *Cavendish* considered that the way in which the penalties' doctrine developed over the 19th and 20th centuries (I interpose, a period dominated by positivism in legal doctrine) led to it being conceived of in a way that is clearly distinct from the equitable treatment of penalties in the 17th and 18th century Courts of Chancery.[35]

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31 See s 8 of the Administration of Justice Act 1696 (8 & 9 Will 3 c 11) (UK) and Administration of Justice Act 1705 (4 & 5 Anne c 16) (UK).

32 *Cavendish Square Holding BV v Makdessi; ParkingEye Ltd v Beavis* [2016] AC 1172 at 1193; [2015] UKSC 67 at [6], *per* Lord Neuberger and Lord Sumption.

33 *Cavendish Square Holding BV v Makdessi; ParkingEye Ltd v Beavis* [2016] AC 1172 at 1208; [2015] UKSC 67 at [42], *per* Lord Neuberger and Lord Sumption.

34 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1208; [2015] UKSC 67 at [42], *per* Lord Neuberger and Lord Sumption.

35 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1193–1194; [2015] UKSC 67 at [6]–[7], *per* Lord Neuberger and Lord Sumption, where it was said at [7]:

> [T]he penalty rule as it was developed by the common law courts in the course of the 19th and 20th centuries proceeded on the basis that although penalties were secondary obligations, the parties meant what they said. They intended the provision to be applied according to the letter with a view to penalising breach. The law relieved the contract-breaker of the consequences not because the objective could be secured in another way but because the objective was contrary to public policy and should not therefore be given effect at all. The difference in approach to penalties of the courts of equity and the common law courts is in many ways a classic example of the contrast

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21 In their view, the nature and purpose of the doctrine changed as penal defeasible bonds lost currency in commercial transactions as the law of contract developed and the common law on penalties was applied only to an assessment of damages clauses which, as "a contractual substitute for common law damages … could not in any meaningful sense be regarded as a mere security for their payment".[36] The doctrine moved from control of securing performance to control of substitutes for damages. Lord Neuberger and Lord Sumption noted that in cases of the early 19th century such as *Astley v Weldon*[37] and *Kemble v Farren*,[38] "the common law courts introduced the now familiar distinction between a provision for the payment of a sum representing a genuine pre-estimate of damages and a penalty clause in which the sum was out of all proportion to any damages liable to be suffered".[39] This apparently binary description of the clause in question (genuine pre-estimate or penalty) formed the basis of the common law courts not enforcing a penal clause, in contrast to the earlier more nuanced response of common law courts under the influence of Chancery practice and also the Statutes of William and Anne.

22 A further distinction seen in the reasons of Lord Neuberger and Lord Sumption is that while the equitable jurisdiction for relief against penal bonds and the equitable jurisdiction for relief against forfeiture may have grown up as brother and sister of equitable relief, they have taken very different paths and represent "distinct causes of action".[40] Equity continued its role in regulating forfeiture provisions, for example, stepping in when there are other options to achieve the performance of the obligations in a lease or mortgage.[41] By contrast, due to the way in which penalty clauses in contract began to be seen in the eyes of the law as a "substitute for common law damages" (as opposed to a mechanism of security), a shift of perspective occurred which meant the equitable jurisdiction in relation to penalties was no longer invoked.[42]

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between the flexible if sometimes unpredictable approach of equity and the clear if relatively strict approach of the common law.

36 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1194; [2015] UKSC 67 at [8], *per* Lord Neuberger and Lord Sumption.

37 *Astley v Weldon* (1801) 2 Bos & P 346.

38 *Kemble v Farren* (1829) 6 Bing 141.

39 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1194; [2015] UKSC 67 at [8], *per* Lord Neuberger and Lord Sumption.

40 Peter W Young, "Recent Cases" (2016) 90 *Australian Law Journal* 22 at 22; see also *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1197; [2015] UKSC 67 at [17], *per* Lord Neuberger and Lord Sumption.

41 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1195; [2015] UKSC 67 at [10], *per* Lord Neuberger and Lord Sumption.

42 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1382; [2015] UKSC 67 at [8], *per* Lord Neuberger and Lord Sumption.

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C. The Australian approach to the history of the penalties' doctrine

23 The High Court in *Andrews* disagreed that defeasible bonds were limited to the event of performance of an obligation with a "contractual character".[43]

24 The difference between the two courts reduces to how a legal instrument is historically characterised and the subsequent development of that instrument.

25 The court in *Andrews* warned that one must be careful with language in this area of the law, particularly in relation to a term such as a "condition" and in circumstances where "the obligation under a bond may be said to be conditioned upon the occurrence of a particular event".[44] The court in *Andrews* held that "the condition may be an occurrence or event which need not be some act or omission of the obligor, analogous to a contractual promise by the obligor".[45] The High Court, thus, placed its emphasis on the fact that the penal bond was not an instrument solely designed to secure performance through extracting a promise, but rather was designed in such a way to secure performance through indebtedness.[46] If payment on a bond was dependent on a condition, and that condition was not necessarily promissory in character, then the event triggering payment did not require the obligor's breach.[47]

26 In what way did the historical analysis of the High Court in the *Andrews* decision differ significantly from previous Australian authority? This, too, is a matter of some contention. In the 1986 High Court case of *AMEV-UDC Finance*, Mason and Wilson JJ in a tolerably plain passage saw the doctrine as one of common law, referring to the "demise" of equity's separate jurisdiction and to it having "withered on

43 *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 226–227; HCA 30 at [42].
44 *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 224; HCA 30 at [35].
45 *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 225; HCA 30 at [39].
46 Samuel Williston, *A Treatise on the Law of Contracts* vol 14 (Thomson Reuters, 4th Ed, 2000) § 42:15, as quoted in *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 224; HCA 30 at [36].
47 *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 225; HCA 30 at [39]; see also Edwin Peel, "The Rule against Penalties" (2013) 129 *Law Quarterly Review* 152 at 153.

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the vine".[48] Other *dicta* in High Court cases were to like effect.[49] This is how the precedential position was taken by lower courts.[50]

27 In *Andrews*, the court held that the statements of Mason and Wilson JJ overlooked "the proposition that the only relevant effect of the Judicature system … was upon the procedures in the unified court system not upon substantive doctrine".[51]

D. *Explaining the difference in historical approach between the Australian and UK Supreme Courts*

28 The Australian decision in *Andrews* was considered by the Supreme Court in *Cavendish*. Lord Neuberger and Lord Sumption gave what might be called short shrift to the historical analysis of the

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48 *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170 at 191; HCA 63 at [35], where Mason and Wilson JJ said the following:

> The advent of the Judicature system, with its emphasis on the disposition of all issues in one proceeding, hastened the demise of equity's separate jurisdiction to relieve against penalties. Although it is not possible to identify when the principle that a penalty is unenforceable became an established rule of law, the Judicature system reinforced the principle. That system strengthened the development which had been taking place in the common law courts since the seventeenth century, whereby all relevant relief could be obtained in the one action in which the plaintiff sued to recover a penalty. It meant that there was no need to invoke the equitable jurisdiction. It is significant that counsel have not drawn to our attention any instance of the equitable jurisdiction to relieve against penalties having been invoked in England since the Judicature Act 1873 (U.K.), let alone any instance of the exercise of the jurisdiction in which compensation awarded has exceeded the amount of damages which would have been awarded at common law in lieu of the penalty. Without exception the cases show that once the agreed sum is held to be a penalty the plaintiff recovers damages for breach of contract in lieu of the penalty. All this leads to the conclusion that the equitable jurisdiction to relieve against penalties withered on the vine for the simple reason that, except perhaps in very unusual circumstances, it offered no prospect of relief which was not ordinarily available in proceedings to recover a stipulated sum or, alternatively, damages.

49 See, *eg*, *IAC (Leasing) Ltd v Humphrey* (1972) 126 CLR 131 at 142–143, *per* Walsh J and *O'Dea v Allstates Leasing System (WA) Pty Ltd* (1983) 152 CLR 359 at 390, *per* Brennan J.

50 See generally *Interstar Wholesale Finance Pty Ltd v Integral Home Loans Pty Ltd* (2008) 257 ALR 292; [2008] NSWCA 310.

51 *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 234; HCA 30 at [68]. In *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 258 CLR 525 at 568; HCA 28 at [123], Gageler J expressed the view that the reasoning in *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170; HCA 63 was never intended to stand for the "more sweeping proposition" that the penalties rule was one of law, not equity, holding, "[t]o fuse the administration of law and equity is not thereby to destroy an equitable doctrine, and for an equitable doctrine to wither is not necessarily for an equitable doctrine to die".

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Australian High Court, holding "although the reasoning in the *Andrews* case was entirely historical, it is not in fact consistent with the equitable rule as it developed historically".[52] This question of so-called fusion of law and equity has generated heat and light for 50 years in Australia since the first edition of the great equity text of Meagher, Gummow and Lehane.[53] It, too, is not without its own controversy.[54]

29 But is it possible that both histories of a legal doctrine and historical methods may be valid?[55] The approach of the High Court of Australia in *Andrews* is one that lends greater emphasis to the earliest origins of legal doctrine. It is also rooted in a clear and strong view as to the lack of substantive (as opposed to procedural) effect of the Judicature Acts. The High Court recognised that most of the cases dealing with defeasible bonds did involve a breach of a promissory obligation (as we would understand the term in contract law today). But it was not prepared to rule out as a matter of history that the non-performance of other non-contractual conditions could also enliven the jurisdiction, in a way that vindicated a fundamental and wider value of obligations – a need to control the unconscientious exercise of power.

30 The historical methodologies of the courts are thus distinct, with the Australians placing higher value on the root systems of legal doctrine and of jurisdiction. The Supreme Court justices, by contrast, revealed: that the penalties rule as it has been engaged for the past two centuries generally has involved breach of a contractual provision; and that this, together with the fusion of law and equity under the judicature system, has caused the clear severance of the doctrine from its equitable roots, or as Mason and Wilson JJ said, the demise and withering on the vine of the equitable jurisdiction.[56] The place of 18th century English equity and the introduction of the judicature system are, thus, central to

52 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1208; [2015] UKSC 67 at [42], *per* Lord Neuberger and Lord Sumption; see also J W Carter *et al*, "Contractual Penalties: Resurrecting the Equitable Jurisdiction" (2013) 30 *Journal of Contract Law* 99.

53 See most recent edition of the text, J D Heydon, M J Leeming, P G Turner, *Meagher, Gummow & Lehane's Equity Doctrines and Remedies* (LexisNexis, 5th Ed, 2015).

54 See papers in, *Equity in Commercial Law* (Simone Degeling & James Edelman eds) (Lawbook Co, 2005).

55 French CJ in *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 258 CLR 525 at 540; HCA 28 at [10] certainly thought so, noting "[m]ore than one account of [the penalty rule's] construction and more than one view of whether it should be abrogated or extended or subsumed by legislative reform is reasonably open".

56 *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170 at 186, *per* Mason and Wilson JJ.

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the differences between the courts.[57] I do not intend to be disrespectful if I say that this kind of historical debate is an unsatisfactory point of distinction for a doctrine so vital to modern commerce that regulates the performance of contracts, in particular when the essence of a reformed modern doctrine is so necessary.

III. Modern definitions of the penalties' doctrine

31 With the historical background as mapped by the two courts in mind, may I now turn to the contemporary history (of but one century) of the penalties' doctrine and how the recent cases have reframed the law in the area.

A. Dunlop *and Lord Dunedin's four tests*

32 *Dunlop*, you will recall, concerned a contract for the supply of trademarked "Dunlop" tyres, tubes and associated products to a garage. As was permitted at that time, the contract contained a resale price maintenance clause with a fee of £5 for every article sold in breach of the agreement. The garage sold the tyres for a lower price, thus breaching the agreement. The court held that the clause providing for the £5 payments was a valid liquidated damages clause.[58] The four tests of Lord Dunedin were summarised by Lord Neuberger and Lord Sumption in *Cavendish* as follows:[59]

> (a) [T]hat the provision would be penal if 'the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach'; (b) that the provision would be penal if the breach consisted only in the non-payment of money and it provided for the payment of a larger sum; (c) that there was a presumption (but no more) that it would be penal if it was payable in a number of events of varying gravity; and (d) that it would not be treated as penal by reason only of the impossibility of precisely pre-estimating the true loss.

33 The contemporary significance of *Dunlop* was that it was an attempt to draw together (after two important House of Lords and Privy

57 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1208; [2015] UKSC 67 at [42], *per* Lord Neuberger and Lord Sumption and *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 223; HCA 30 at [63].

58 See remarks in *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1198–1199; [2015] UKSC 67 at [21], *per* Lord Neuberger and Lord Sumption.

59 See *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1199; [2015] UKSC 67 at [21], *per* Lord Neuberger and Lord Sumption.

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Council decisions in *Clydebank*[60] and *Hills*)[61] centuries of cases in equity and at common law and the differing approaches of judges with different philosophical views into a stable structure that yet provided for flexibility. The framework laid down by Lord Dunedin had two central features. The first was the identification of the legal technique – he called it "this task of construction".[62] This can be seen, if only in language, to be a nod to those judges (such as Lord Eldon and Sir George Jessel) who had given primacy to the intention of the parties, in particular in describing the clause as what was by then the reflex of the penalty: the genuine pre-estimate of damage. But Lord Dunedin did not mean construction in the strictly textual and interpretive sense. He meant characterisation of all the circumstances including (but not bound by) the language of the parties: "upon the terms and inherent circumstances of each particular contract".[63] The second feature was the expression of tests or rules that had a significant degree of certainty but which sought to embody the value-based heart of the doctrine: a money stipulation that is extravagant and unconscionable in amount compared with the greatest loss that conceivably be proved to have followed from the breach.[64]

34 Around these two features moved the "propositions" that should not (though too often were) taken as rules: the notion (ambiguous in itself) of the genuine pre-estimate of damage, the payment of a greater sum than should have been paid, a single lump sum payable on the occurrence of one or more events, some of which may be trifling, and the difficulty of pre-estimation of damage.

35 Another feature of *Dunlop* that came from the speech of Lord Atkinson which has become central in the recent cases is the broad justification for the impugned provision by reference to the legitimate interests of the obligee.[65]

36 The core of the matter is extravagance and unconscionability of compensation by reference to the greatest possible loss. Such concepts have an obvious and direct relationship with the protection of the

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60 *Clydebank Engineering and Shipbuilding Co Ltd v Yzquierdo y Castaneda* [1905] AC 6.

61 *Commissioner of Public Works v Hills* [1906] AC 368.

62 *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 at 87, *per* Lord Dunedin.

63 *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 at 87, *per* Lord Dunedin.

64 *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 at 87, *per* Lord Dunedin.

65 *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 at 92–93, *per* Lord Atkinson.

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legitimate interests of the parties. One can (as the cases from the 19th century did) seek to concretise the law to give certainty – that a genuine pre-estimate of damage is not a penalty. But if these two alternatives are the rule-based universe – penalty or genuine pre-estimate – what if the parties have not sought to pre-estimate the damages? Must it be a penalty? Of course not. One justifies this answer either by giving the phrase "genuine pre-estimate of damages" a wide meaning – that it is of an amount that could be seen to be a genuine pre-estimate, irrespective of what the parties actually did, or by using the phrase only when the parties did seek to make such a pre-estimate, but in addition by recognising that there are circumstances where even if they have not done so, the clause may still not be a penalty.

37 At this point, we are approaching the heart of the doctrine as previously expressed: the absence of extravagance or unconscionability by reference to the greatest possible loss. One could, perhaps in the search for certainty, make this assessment by going to rules about recovery of damages under *Hadley v Baxendale*[66] against which to compare the amount in the clause. Or, one could take a broader conception, at a more general level of abstraction, involving the legitimate protection of the interests of the obligee in a manner that is not viewed as extravagant and unconscionably harsh. The former has tended to be the approach taken until recently; the latter has now commended itself to both the Supreme Court and the High Court. This reflects the importance of Lord Atkinson's speech being read with the more elaborate and structured approach of Lord Dunedin.

38 In *Cavendish*, the solution was found by (sensibly) denying the binary reflex of genuine pre-estimate and penalty and introducing a third category of the commercially justifiable protection of legitimate interest, by approving the approach of Colman J in *Lordsvale Finance plc v Bank of Zambia*,[67] of Mance LJ in *Cine Bes Filmcilik ve Yapimcilik v United International Pictures*[68] and of Arden LJ in *Murray v Leisureplay plc*[69] and of the Full Court in *Paciocco*.[70]

B. The modern penalty doctrine in Australia

39 In *Andrews*, around 38,000 members of the group proceeding claimed that certain provisions in their retail deposit and business deposit accounts were penalties. At first instance, Gordon J held that

66 *Hadley v Baxendale* (1854) 9 Ex 341; 156 ER 145.
67 *Lordsvale Finance plc v Bank of Zambia* [1996] QB 752.
68 *Cine Bes Filmcilik ve Yapimcilik v United International Pictures* [2004] 1 CLC 401.
69 [2005] EWCA Civ 963.
70 *Paciocco v Australia and New Zealand Banking Group Ltd* [2015] FCAFC 50.

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only those late payment fees imposed on credit card holders following breach of a requirement of a monthly payment constituted penalties.[71] In contrast to honour fees, dishonour fees and non-payment fees, late payment fees were found on the facts to be imposed upon a breach of contractual duty by a bank customer and in those circumstances and in light of intermediate appellate court authority, Gordon J found the penalties' jurisdiction to be enlivened for the late payment fees.[72]

40 The High Court (the matter bypassing the Full Court of the Federal Court) did not see contractual breach as a necessary event to trigger the penalties' jurisdiction and instead reframed the penalties' rule as follows:[73]

> In general terms, a stipulation *prima facie* imposes a penalty on a party ('the first party') if, as a matter of substance, it is collateral (or accessory) to a primary stipulation in favour of a second party and this collateral stipulation, upon the failure of the primary stipulation, imposes upon the first party an additional detriment, the penalty, to the benefit of the second party. In that sense, the collateral or accessory stipulation is described as being in the nature of a security for and *in terrorem* of the satisfaction of the primary stipulation. If compensation can be made to the second party for the prejudice suffered by failure of the primary stipulation, the collateral stipulation and the penalty are enforced only to the extent of that compensation. The first party is relieved to that degree from liability to satisfy the collateral stipulation.

The most notable aspect of this definition is that relief against a penalty is conditioned upon the failure of the primary stipulation (as opposed to breach of a contractual obligation). In that way, the definition is one that allows for both common law and equitable relief from penalties. A further point to note is the fact it allows for partial enforcement in the sense that "the collateral stipulation and the penalty are enforced only to the extent of that compensation",[74] in the manner that courts of equity and at common law had done before the 19th century.

41 *Andrews* was focused on the engagement of the doctrine. There was no extended discussion of the nature of the penal doctrine, though, in one broad phrase, the court encapsulated the enquiry. Drawing on the broader formulation of the innocent party's interests as articulated

71 *Andrews v Australia and New Zealand Banking Group Ltd* [2011] FCA 1376; 211 FCR 53.
72 *Andrews v Australia and New Zealand Banking Group Ltd* [2011] FCA 1376; 211 FCR 53.
73 *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 216–217; HCA 30 at [10].
74 *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 216–217; HCA 30 at [10].

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by Lord Atkinson in *Dunlop*, the High Court in *Andrews* said it would look to "whether the sum agreed was commensurate with the interest protected by the bargain".[75]

42 This idea of legitimate interest (which is central to the UK reasoning) was adopted by the High Court in *Paciocco*. In that appeal, the court considered whether the AU$20 late payment fees charged to credit card holders upon failure to make the minimum monthly repayment were penalties.

43 Kiefel J (with whom French CJ agreed) formulated the test as whether the sum imposed was "out of all proportion to the interests of the party which it is the purpose of the provision to protect".[76] The interests were identified as "operational costs, loss provisioning and increases in regulatory capital costs".[77]

44 Keane J (in an approach that reflected, though did not cite, an important *obiter dicta* of Mason and Wilson JJ in *AMEV-UDC* to which I will come) put particular focus on the function of the penalty rule as one that regulated the way in which parties use their bargaining power to impose punishment on other contracting parties.[78] Where the sum was not at all proportionate or commensurate with legitimate commercial interest, he said, "the punitive character of the provision stands revealed".[79]

45 Gageler J focused on what, smilingly, may be described as the yin and yang of commercial bargains in describing a test where the "negative incentive to perform" is "so far out of proportion with the positive interest in performance that the negative incentive amounts to deterrence by threat of punishment".[80]

75 *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 236; HCA 30 at [75].
76 *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 258 CLR 525 at 547; HCA 28 at [29], *per* Kiefel J.
77 *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 258 CLR 525 at 555; HCA 28 at [58], *per* Kiefel J.
78 See discussion in punishment as rationale for the doctrine in Professor Sarah Worthington QC, "The Death of Penalties in Two Legal Cultures?" (2016) 7 *The UK Supreme Court Yearbook* 129 at 140–141.
79 *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 258 CLR 525 at 607; HCA 28 at [256], *per* Keane J.
80 *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 258 CLR 525 at 580; HCA 28 at [164], *per* Gageler J.

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C. The modern penalty doctrine in the UK

46 There were three substantial and two concurring (but important) judgments in *Cavendish* and *ParkingEye*.

47 In their reasons, Lord Neuberger and Lord Sumption offered the following by way of definition of the "true test":[81]

> [W]hether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation …

48 Lord Hodge (with whom in this respect Lord Toulson agreed) expressed it not dissimilarly: "whether the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party's interest in the performance of the contract".[82] Lord Mance expressed a test similar to that of Lord Hodge: the need to identify any legitimate business interest and whether the provision is extravagant, exorbitant and unconscionable by reference to it.[83] Lord Clarke agreed with Lord Hodge and Lord Mance.

49 One can see two essential elements in these formulations, both having evaluative features: the distinction between a primary and a secondary obligation; and the absence of a compensatory damages analysis based on an extravagant or unconscionable exceeding of what might be the greatest damages, but rather a relationship between the interests of the obligee and the degree to which the sum exceeds those interests.

50 These tests were applied to the facts of the appeals in the following way. In the first appeal, the sellers agreed to transfer the sale shares (which represented the majority shareholding of the communications group) and were to be paid in instalments. Clause 11 prevented the sellers from engaging in competitive business behaviour in any of the so-called "prohibited areas", namely, the countries where the group carried on business. Clauses 5.1 and 5.6 were the clauses under scrutiny. Clause 5.1 provided that if the seller breached the restrictive covenants, he would not be entitled to receive the later

81 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1204; [2015] UKSC 67 at [32], *per* Lord Neuberger and Lord Sumption.
82 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1278; [2015] UKSC 67 at [255], *per* Lord Hodge.
83 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1247; [2015] UKSC 67 at [152], *per* Lord Mance.

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payments.[84] Clause 5.6 granted to Cavendish a call option for the retained shares of the seller valued at a price excluding the goodwill of the business.[85]

51 There was disagreement as to whether to characterise cll 5.1 and 5.6 as primary or secondary obligations.[86] Lord Neuberger and Lord Sumption found that cll 5.1 and 5.6 were not penalty clauses but were on their proper characterisation price adjustment clauses.[87] The clauses could be characterised as primary provisions by virtue of the fact that they were determinative of the pricing of the contract.[88]

52 Lord Hodge said whether or not cl 5.1 was to be characterised as a primary obligation or secondary provision operating on breach (he and Lord Clarke formed the view that it was a secondary obligation), it was not an unenforceable penalty clause. He pointed to evidentiary factors (*ie*, that the goodwill value of the company was highly determinative in fixing the purchase price) and noted that the fact of including deferred consideration through the payment instalments signalled Cavendish's legitimate interest in "addressing the disloyalty of a seller who was prepared in any way to attack the company's goodwill".[89] Lord Mance placed particular emphasis on the fact that both sides had received sophisticated legal advice and all parties were hard-headed about the implications of the terms of the agreement.[90] One can begin to see the importance of the equality of the bargaining position to the assessment of exorbitance or unconscionability by reference to interest.

53 In *ParkingEye*, the £85 parking fine was found to be a secondary obligation operating on breach. The legitimate interest of a carpark in charging a proportionate sum extended beyond the recovery of any loss from the particular breach (as it had in *Dunlop*). Lord Sumption and Lord Neuberger emphasised that a legitimate interest could include a legitimate interest in influencing the behaviour of a contracting party, for another legitimate interest, namely, the commercial interest of

84 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1212; [2015] UKSC 67 at [55], *per* Lord Neuberger and Lord Sumption.
85 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1212; [2015] UKSC 67 at [55], *per* Lord Neuberger and Lord Sumption.
86 See discussion in Goh Yihan & Yip Man, "The English Reformulation of the Penalty Rule: Relevance in Singapore?" (2017) 29 SAcLJ 257.
87 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1217; [2015] UKSC 67 at [74], *per* Lord Neuberger and Lord Sumption.
88 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1217; [2015] UKSC 67 at [74], *per* Lord Neuberger and Lord Sumption.
89 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1182; [2015] UKSC 67 at [275], *per* Lord Hodge.
90 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1257; [2015] UKSC 67 at [181], *per* Lord Mance.

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allowing as many customers to park in the parking centre as possible.[91] The fact of the court's concession that deterrence is not penal in and of itself represents "[a]n explicit recognition that parties may have legitimate interest in performance, not merely in compensation for non-performance".[92]

IV. Comparison of the Australian and UK approach to penalties

A. Practical differences

54 Before turning to the extent that the penalties' doctrine can be said to have taken a different path in Australia and the UK, the first thing to note as a matter of practicality is that assertions of penalties in both jurisdictions rarely succeed.[93] Also, the focus on the importance of the parties' legitimate interests will help to underpin freedom of contract and party autonomy.

55 The most significant and obvious differences now between Australia and the UK are that in the UK, courts will require contractual breach for engagement of the doctrine, whereas Australian courts will not, and importantly for relief, the equitable jurisdiction permits *pro tanto* enforcement.

56 There are, however, strong linguistic similarities between the way in which the two courts have formulated their "tests" to describe what is penal.[94] The distinction is drawn in Australia between primary stipulations and collateral stipulations. The collateral stipulation does not necessarily require breach of the primary stipulation, but it will in some way be collateral in the sense of accessorial to the primary obligation; and, it has a relationship to the availability of compensation.[95] In the UK, the language of primary and secondary obligations has been chosen, at least by Lord Neuberger and

91 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1231; [2015] UKSC 67 at [111], *per* Lord Sumption and Lord Neuberger; see also Peter W Young, "Recent Cases" (2016) 90 *Australian Law Journal* 22 at 23.

92 Professor Sarah Worthington QC, "The Death of Penalties in Two Legal Cultures?" (2016) 7 *The UK Supreme Court Yearbook* 129 at 146.

93 Professor Sarah Worthington QC, "The Death of Penalties in Two Legal Cultures?" (2016) 7 *The UK Supreme Court Yearbook* 129 at 132.

94 Professor Sarah Worthington QC, "The Death of Penalties in Two Legal Cultures?" (2016) 7 *The UK Supreme Court Yearbook* 129 at 141.

95 Professor Sarah Worthington QC, "The Death of Penalties in Two Legal Cultures?" (2016) 7 *The UK Supreme Court Yearbook* 129 at 141.

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Lord Sumption, with the secondary obligation triggered by breach of the primary obligation.[96]

57 The Supreme Court has retained the link to breach of contract. This leads to a stability in engagement of the doctrine. There remains, however, a process of constructional characterisation in order to assess whether the clause is secondary or primary. Though minds sometimes differ on these questions (as they did in *Cavendish* as to cll 5.1 and 5.6), the process is a familiar one in legal and judicial technique. Why the distinction is necessary is a good question. It simply reflects the limit to which the courts have been willing to interfere in bargains. The doctrine is not a general charter for reforming harsh contracts, but it is a foundation for limitations on relief where the courts are involved.

58 The engagement of the doctrine is less stable in Australia. The more abstracted notions of primary and collateral stipulations not conditioned on breach, but related to the availability of compensation (which provides the equity to the doctrine) as set out in *Andrews*,[97] must be superimposed on any bargain. This will not be without its challenges.

59 Both courts have loosened the stability of the "tests" of what is penal by dismantling the dichotomy between genuine pre-estimate of damages and penalty as the paradigm around which the analysis turns, by moving away from Lord Dunedin's tests, and by introducing the broader concept of legitimate interests of the obligee drawn from Lord Atkinson in *Dunlop* and the Earl of Halsbury LC in *Clydebank*. That loosening of stability is in aid of a more evaluative approach that gives considerable weight to the bargain and autonomy of the parties, and so through evaluation, not rules, brings certainty through confidence in principle. These developments can be seen in *Paciocco*, *Cavendish* and *ParkingEye*, though less so in *Andrews*.

B. Differences in values?

60 Often, the doctrine of penalties is spoken of in terms of a contest of legal values, particularly because of the fact of the court's stepping in to review the terms of a contract agreed between the parties in their operation could be cast as a challenge to the common law value of freedom of contract.

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96 Professor Sarah Worthington QC, "The Death of Penalties in Two Legal Cultures?" (2016) 7 *The UK Supreme Court Yearbook* 129 at 141.

97 *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 216–217; HCA 30 at [10].

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61 Freedom of contract is an important common law norm. It underpins the value of adherence to the promise freely undertaken. Lord David Hope suggested in a recent lecture that the penalties doctrine should not apply to commercial contracts where both parties are of equal bargaining power.[98] He suggested that an appreciation of the importance of what was said by Mason and Wilson JJ in *AMEV-UDC* would enable this result. Counsel for *Cavendish* argued that the doctrine should be abolished altogether or, at the very least, should be restricted in commercial cases involving parties of equal bargaining power where contracts were drawn up by skilled legal teams. That submission was rejected by the Supreme Court.[99]

62 Lord Neuberger and Lord Sumption addressed the "freedom of contract" argument by attempting to draw a clear distinction between "a jurisdiction to review the fairness of a contractual obligation and a jurisdiction to regulate the remedy for its breach".[100] In this way, the penalties' jurisdiction is conceived not so much as an interference with the bargains as it is a regulation of (and only of) remedies flowing from breach of the parties' primary obligations.[101]

63 On the issue of freedom of contract, the High Court in *Andrews* sounded a note of caution against "dealing with the unwritten law as if *laissez faire* notions of an untrammelled 'freedom of contract' provide a universal legal value".[102] The statement was, I think, simply recognition that in law, certain values do not, and should not, dominate at the expense of others. Perhaps a better way of putting the balance of freedom of contract with other values was the way Mason and Wilson JJ put it in *AMEV-UDC*.

64 Has either court provided a convincing rationale for the doctrine? Prof Worthington has argued that both courts have failed

98 Lord David Hope, "The Law on Penalties – A Wasted Opportunity?" (2016) 33 *Journal of Contract Law* 93, headnote and at 98.
99 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1206–1206; [2015] UKSC 67 at [36]–[39], *per* Lord Neuberger and Lord Sumption; at [162]–[170], *per* LordMance; at [256]–[268], *per* Lord Hodge; at [291], *per* Lord Clarke.
100 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1196; [2015] UKSC 67 at [13], *per* Lord Neuberger and Lord Sumption.
101 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1196; [2015] UKSC 67 at [13], *per* Lord Neuberger and Lord Sumption; see also Professor Sarah Worthington QC, "The Death of Penalties in Two Legal Cultures?" (2016) 7 *The UK Supreme Court Yearbook* 129 at 140–141.
102 *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 216; HCA 30 at [5].

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in this respect.[103] The rationale offered by Lord Neuberger and Lord Sumption is that "the law will not generally make a remedy available to a party, the adverse impact of which on the defaulter significantly exceeds any legitimate interest of the innocent party".[104] What might be described as a "rationale against punishment" appears to have resonated strongly in the Australian court, especially in the judgments of Keane and Gageler JJ.[105]

V. A doctrine to regulate power

65 The doctrine is about the control of private power in society.

66 An argument that the doctrine represents an undue interference with freedom of contract, and therefore should be abolished, has the premise that private power should not be regulated by law. But freedom of contract is one legal value among many.

67 The language and spirit of unconscionability are drawn from equity. In that sense, to acknowledge the history of the doctrine as one emerging from the equitable jurisdiction lends coherence to the doctrine. The control of power, balanced with party autonomy, provides the foundation for development and application of principle that requires parties to conduct themselves in a manner that is in accordance with human standards of conscionability and proportion in the light of legitimate interests.

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103 Professor Sarah Worthington QC, "The Death of Penalties in Two Legal Cultures?" (2016) 7 *The UK Supreme Court Yearbook* 129 at 140.

104 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1203; [2015] UKSC 67 at [29], *per* Lord Neuberger and Lord Sumption.

105 See Professor Sarah Worthington QC, "The Death of Penalties in Two Legal Cultures?" (2016) 7 *The UK Supreme Court Yearbook* 129 at 140–141. In *Paciocco v Australia and New Zealand Banking Group Ltd* (2016) 258 CLR 525 at 606; HCA 28 at [253], Keane J said: "it is no part of the law of contract to allow one party to punish the other for non-performance". In this respect, he cited Lord Hoffman in *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] AC 1 that "the purpose of the law of contract is not to punish wrongdoing but to satisfy the expectations of the party entitled to performance". Gageler J asked, at [159], whether the stipulation in question is "a genuine pre-estimate of the [innocent party's] probable or possible interest in the due performance of the principal obligation' or a penalty 'merely [included in the contract] to secure the enjoyment of a collateral object'". It will be the latter, Gageler J said, at [158], if "the conclusion objectively to be drawn from the totality of the circumstances is that the only purpose of the stipulation was to punish: to impose a detriment on a contracting party in the event that a principal contractual stipulation is not observed, in order to deter non-observance of that principal stipulation".

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68 Once it is accepted that the doctrine is based on denying, as a matter of legal policy, the legitimacy of requiring the court to enforce extravagant and disproportionate provisions reflective of an unconscionable use of power that effectively punish rather than compensate, it becomes evident that the task is evaluative and rests on characterisation, rather than being the *a priori* application of a limited body of defined taxonomically arranged rules. That is not to say that the attempts at coherence such as by Lord Dunedin should not be continued to be utilised for assistance. Various members of the Supreme Court emphasised this evaluative approach and the inability to lay down any abstract rule.[106] Lord Neuberger and Lord Sumption emphasised what the Earl of Halsbury LC had said in *Clydebank*:[107]

> [W]hat I think gave jurisdiction to the courts in both countries [England and Scotland] to interfere at all in an agreement between the parties [was whether it is] unconscionable or extravagant, and one which no court ought to allow to be enforced.

69 It is their role in enforcement that engages the courts. That is a historical, practical and doctrinal justification for the interference. The identification of the justification for the doctrine is perhaps more clearly illuminated in *Andrews* and *Paciocco* than in *Cavendish* and *ParkingEye*. The doctrine may reflect some misshapenness from centuries of precedent, but that is largely a function of judges, from time to time over those centuries, trying to define the indefinable. This was powerfully recognised by Lord Neuberger and Lord Sumption in *Cavendish*.[108]

70 Their Lordships emphasised the core evaluative task, and they illuminated that the problems come when one insists on defining the indefinable. That the doctrine is experientially based, not logically founded on abstracted rules, is a powerful reinforcement of the true

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106 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1204; [2015] UKSC 67 at [31], *per* Lord Neuberger and Lord Sumption; at [293], *per* Lord Toulson.

107 *Clydebank Engineering and Shipbuilding Co Ltd v Yzquierdo y Castaneda* [1905] AC 6 at 10, as quoted in *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1198; [2015] UKSC 67 at [20], *per* Lord Neuberger and Lord Sumption.

108 *Cavendish Square Holding BV v Makdessi*; *ParkingEye Ltd v Beavis* [2016] AC 1172 at 1204; [2015] UKSC 67 at [31], *per* Lord Neuberger and Lord Sumption, where it was said:

> [T]he law relating to penalties has become the prisoner of artificial categorisation, itself the result of unsatisfactory distinctions: between a penalty and genuine pre-estimate of loss, and between a genuine pre-estimate of loss and a deterrent. These distinctions originate in an over-literal reading of Lord Dunedin's four tests and a tendency to treat them as almost immutable rules of general application which exhaust the field … All definition is treacherous as applied to such a protean concept.

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nature of the doctrine and of its capacity to apply in the control of power – such as in standard form contracts: see the discussion in *Cavendish* of the *Philips Hong Kong* case.[109] The recognition of the importance of legitimate interests, and the balance with freedom of contract was perhaps no better said than by Mason and Wilson JJ in *AMEV-UDC* in 1986, which could perhaps have been given some express attention in *Andrews* and *Paciocco*:[110]

> The test to be applied in drawing [the distinction between compensation and unconscionable and oppressive and so penal contracts] is one of degree and will depend on a number of circumstances, including (1) the degree of disproportion between the stipulated sum and the loss likely to be suffered by the plaintiff, a factor relevant to the oppressiveness of the term to the defendant, and (2) the nature of the relationship between the contracting parties, a factor relevant to the unconscionability of the plaintiff's conduct in seeking to enforce the term. The courts should not, however, be too ready to find the requisite degree of disproportion least they impinge on the parties' freedom to settle for themselves the rights and liabilities following a breach of contract. The doctrine of penalties answers … an important aspect of the criticism often levelled against unqualified freedom of contract, namely the possible inequality of bargaining power. In this way the courts strike a balance between the competing interests of freedom of contract and protection of weak contracting parties …

As Lord Hope has clearly said, this seminal passage from contemporary and eminent judges contains the basis for a modern and nuanced reformulation of the doctrine that employs concepts such as inequality of bargaining power, to underpin and to control freedom of contract.[111] Neither court took up this opportunity fully.

71 Neither law nor equity would, or should, countenance unconscientious abuse of power. That statement is an informing principle. It explains the rule against restraint of trade, the doctrine of penalties, the rules concerning duress and *non est factum*, and the principle of good faith in the law of contract (as a general principle and as illustrated in particular common law rules), and countless equitable rules and discretions. It is the informing principle that underpinned what was said by Mason and Wilson JJ in *AMEV-UDC*.

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109 *Cavendish Square Holding BV v Makdessi; ParkingEye Ltd v Beavis* [2016] AC 1172 at 1204; [2015] UKSC 67 at [35], *per* Lord Neuberger and Lord Sumption, quoting *Philips Hong Kong Ltd v The Attorney General of Hong Kong* (1993) 61 BLR 41 at 57–59; [1993] UKPC 3a.

110 *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170 at 193–194, *per* Mason and Wilson JJ.

111 Lord David Hope, "The Law on Penalties – A Wasted Opportunity?" (2016) 33 *Journal of Contract Law* 93 at 97–98.

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72 Once the source and content of the informing norm is clear, its inhering experiential contextualism is illuminated by real cases giving guidance from real life. They do not create rules; they provide experiential guidance in the application of normative principle. We have centuries of those cases. Sometimes, a doctrinal structure of rules has been placed around them. But if we recognise the implicit in all of these cases, they do make sense – even if minds might differ about the characterised result in each case.

73 Take *Tall v Ryland* in 1670.[112] Two fishmongers had shops nearby. After some exhibition of trade slander and bad behaviour by one of them, he gave a bond of £20 conditional to behave himself civilly towards the other and not to disparage his goods. He broke it by commenting on the stink of his rival's fish. Judgment at law was given on the bond. The Lord Keeper, Sir Orlando Bridgman, refused the plaintiff's bill in Chancery to be relieved of the verdict at law on the basis of the smallness of damage. The defendant demurred, alleging that there was no way to measure the damage. The demurrer was allowed, but the defendant was denied costs; but his Lordship declared that this was not to be a precedent in the case of a bond for £100. Evaluative proportion and sensible interest lay at the heart of this approach. Who could disagree that this was a sensible response of an experientially based rule? The answer is: perhaps only the judge who demands a world of defined rules in a stable and certain taxonomical structure.

74 We should not despair about penalties. Both courts (the Supreme Court and the High Court) have reached value-based tests conformable with a degree of flexibility, and both have eschewed an overly prescriptive approach of precedent and rule. Perhaps the High Court has been more willing to illuminate the longer and deeper historical source (and therefore the nature) of the norms that underpin the doctrine. However, neither court, but especially the High Court, has taken the opportunity fully to fashion the doctrine for modern commerce in a nuanced way suggested by Mason and Wilson JJ in *AMEV-UDC*, to distinguish between contractual circumstances and to make evaluative judgments as to the presence or absence of oppression and extravagance informed by the equality or inequality of bargaining power and like considerations.

75 The struggle with penalties perhaps reflects an ever-present dynamic relationship in the law. It is dynamic because of the necessary fluidity of doctrine as society and life change over time under the influence of different social, economic and philosophical forces. Thus, it

112 *Tall v Ryland* (1670) 1 Cas in Ch 183, as discussed in A W B Simpson, "The Penal Bond with Conditional Defeasance" (1966) 82 *Law Quarterly Review* 392 at 418.

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is the human and experiential force of law which is the source of energy for change. But it stirs the craving for certainty which is the source of the demand for structure, for taxonomy and for rules.

76 The balance between the two is vital. Vital also is the recognition of the indefinability in an abstracted de-contextualised sense of core concepts such as oppression, unconscionability and abuse of power. Vital also is the recognition of the importance of clarity of expression and of rules – up to, but no further than, the end point of utility of expression and of rules. Values need some rules for coherence of form, reasonable predictability in particular application and in directing avenues for change and development. Rules need values for coherence and modesty in structure and expression in order to retain a conformity with human experience – in other words, for legitimacy.

77 Not only in this relational dynamic in the law, one sees the different drivers and searches – for contextual and experiential whole reality on the one hand, and abstracted de-contextualised rule-based (so-called) certainty on the other, in the personality of lawyers (judges, practitioners and academics), in the techniques they use to think about the law, in the doctrine they develop, and in their application of the law to particular cases.

78 This is, I would suggest, a reflection of the inescapable humanity of the law.

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